

Revenue Laws – November 10, 2010

Background

Let me start by giving you some history on how we got to this problem of 240,000 “backlogged” items.

In 1994 the Department launched ITAS, the same computer system we use today for processing returns and tax information. That system – now very antiquated—generates flagged items that require a human being – an employee of Revenue – to review.

A flagged return essentially means a taxpayer’s account is out of balance – either over or underpaid or maybe lacking information. We call these “review items”.

In 2009, ITAS generated 910,000 review items. We worked 898,000. Imagine how time consuming and costly it is to have employees review each of these cases. It costs the State millions and millions of dollars each year.

The 240,000 review items that received media attention, is the accumulated left-over balance of review items for a number of years.

Many of those items are generated through taxpayer error.

The Department has to help the taxpayer by correcting the situation, and we take our due responsibility for not being able to do that as quickly as would be ideal.

By the way, we have processed 80 percent of those items, but I’ll get down into the numbers and what they mean in a few minutes.

A Question of Policy

You have asked about our policy on this issue. The Department has no written or long-standing policy regarding refunds that are out of statute. We have searched but can find no written document.

A series of emails last fall raised the question of how the Department would process out of statute refunds. If there had been an agency-wide written policy, the question would have been unnecessary.

In actuality a few of our administrative staff had a long-practiced way of doing things—that practice was not shared among the entire agency.

What we had was inconsistency among different divisions—not a policy change.

DOR's Interpretation of the law

The Department of Revenue interpreted and still interprets the law to mean that a refund is “discovered” when a human body reviews an account and verifies that a refund is in fact due the taxpayer.

When a refund is “discovered” out of statute, the Department is prohibited by law from issuing the refund. We will work with the General Assembly to get statutory authority to make these refunds.

By the numbers

240,000 review items were part of the “backlog”.

We have processed 80 percent of those items.

Of those we have completed so far:

- 14,000 were refunds less than \$1 each – but still had to be reviewed
- 36,000 were returns filed late and out of statute by the taxpayer
- And some of them were assessments where the taxpayer owed the state money

But let’s talk about the specific refunds that were part of media coverage—unrequested individual refunds that were out of statute and not yet discovered by the Department.

There are 7 thousand of those refunds worth \$2.3 million waiting for legislative action by the General Assembly to be sent out. We will send those as soon as the law allows.

A total of \$20 million in individual income refunds have already gone out the door during this process.

Of the 20% of review items left to process, most are sales and corporate tax issues-which are generally more complicated and time consuming.

We are on track to complete those by the deadline given by the Governor of Dec. 22nd.

The Impact on Revenue

As I mentioned earlier, we worked 898,000 of the 910,000 cases our computer system flagged in 2009. To put it into perspective, we are getting about a million flagged returns a year.

Review items tend to come at us like a tsunami—more are created than can be processed with the resources available. Since August 17th alone, 37,000 review items have been generated.

A large number of these items require an employee at the level of auditor or above to verify and correct returns, which as I said earlier are many times the taxpayer's error.

The Fix

How do we fix this problem from happening again in the future? It is not an easy fix.

It's a complex and very technical situation, but we are doing everything we can—with the resources we have available—to reduce the number of returns flagged.

We are constantly evaluating ITAS—our 16 year old IT system—and the way it generates these new review items. We are adjusting tolerance levels in order to reduce the number of returns that are flagged for human review.

That's the first thing.

We are also the process of implementing TIMS, a new tax computer system that should also resolve some but not all of these issues.

Improvements to our e-services will simplify and speed up the filing of tax return—while reducing common errors that can cause frustrating delays in processing refunds. As more taxpayers file returns electronically, that will reduce the number of human errors that require a DOR employee to manually correct the issue.

Most importantly, we must continue to prioritize our resources in order to complete the large volume of work DOR handles each and every day. During the past two years, we lost 200 full-time temporary employees and currently have 150 frozen vacancies.

I was a legislator for 18 years, and I know now more than ever the citizens of North Carolina are facing tough and uncertain times. But what is certain—DOR is working tirelessly to correct the problems that caused this backlog of refunds, and is committed to efficiently serving the taxpayers of this State.

I have discovered in my first two weeks as Secretary that we have a lot of talented and dedicated people at DOR, and we will get it right.